Section II
Production

Chapter 8
Operator and Management Agent Analysis

8.1 Introduction

Operators and Management Agents that operate FHA-insured residential healthcare facilities play a key role in providing quality housing and health services, critical to the success of the project over the life of the mortgage. To this end, ORCF requires that detailed Operator and/or Management Agent documents be submitted for approval with the application or when there is a proposed change in the Operator and/or Management Agent.

It is the Lender's responsibility to review whether the proposed Operator and/or Management Agent demonstrate the capability and track record to assure that the project will be operated in a prudent, efficient, and cost-effective manner, while providing excellent care to the residents.

ORCF holds the Borrower ultimately accountable for all functions and actions necessary to sustain an insured healthcare project. That ultimate project responsibility holds regardless of the Regulatory and/or Management Agreements the Operators and/or agents sign.

Once the Lender recommends approval, ORCF must also approve a proposed Operator and/or Management Agent prior to their involvement in a Section 232 project.

8.2 Operators

An "Operator," for purposes of projects insured under Section 232 of the National Housing Act, is the legal entity licensed by the applicable state licensing authority to "operate" a particular healthcare project. Thus, the state awards a particular entity the right to provide resident care services and to conduct the usual and necessary business matters of a healthcare provider at the designated project. Thereafter, the state holds the licensee accountable for its healthcare services provided and its business conduct in accordance with existing standards and regulations.
In certain jurisdictions, the state licensing authority may name more than one entity on the project operating license. For purposes of ORCF requirements, all such entities shall be

considered an Operator and shall be held to the same submission standards and regulatory requirements.

ORCF requires that an operator of an FHA-insured healthcare project be licensed as the project Operator by the state. ORCF also requires that the Operator be a single-asset entity acceptable to the Commissioner, and that it possess all powers necessary and incidental to operating the healthcare project. Occasional exceptions may be granted under such circumstances, terms and conditions determined and specified by the Commissioner. Circumstances under which exemption from this single asset operator entity requirement may be considered are set forth in Production, Chapter 2, at 2.5C.

In some cases, the licensed Operator of a healthcare project may also be the owner of the project. These circumstances, where the same entity is both Borrower and Operator, are acceptable to HUD and may be referred to by the terms "Owner/Operator" or "Borrower/Operator." In those instances, the same entity signs the Healthcare Regulatory Agreement-Borrower, Form HUD-92466-ORCF, and the separate Healthcare Regulator Agreement-Operator, Form HUD-92466A-ORCF. The same entity also signs the Security Instrument, Form HUD-94000-ORCF and the Operator Security Agreement, Form HUD-92323-ORCF. Both the Opinion of Borrower's Counsel, Form HUD-91725-ORCF and the Opinion of Operator's Counsel, Form 92325-ORCF are also required.

More common are arrangements in which the Borrower leases the project to a separate healthcare provider entity which is granted the operating license from the state and which is separately approved as the Operator by ORCF. In such cases, the Operator is usually not subject to Borrower oversight or limits on its powers required to operate the healthcare project. Such an entity may be referred to as a "lessee-operator." Under such circumstances, HUD requires that the operating lease between the Borrower and the ORCF approved Operator conform to HUD Program Obligations. In part, those obligations require the incorporation of the Operating Lease Addendum, Form HUD-91116-ORCF, which ensures that the Operator is held accountable for all business and healthcare services and the related cash flows from providing those services.

In yet another circumstance, a licensed Operator, rather than leasing the project, contracts with the Borrower to operate the project for a negotiated fee (through, for example, an "Operating Agreement" or a "Management Agreement"). In such circumstances, including those in which a Management Agent is the co-licensee for a healthcare project, such entity shall be subject to the same requirements as an Operator. In these instances, the contract made between the Borrower and approved Operator requires ORCF approval. In any case HUD ORCF enforces the Operator's responsibilities via the Healthcare Regulatory Agreement-Operator.

In some situations, the managing entity may be contractually defined as a Management Agent, but ORCF would deem that entity to be the Operator (and thus would require the Healthcare Regulatory Agreement-Operator) if any of the following apply:

A. the entity's name appears on the state-issued facility operating license;
B. the entity holds the Provider Agreements with CMS;
C. the entity contracts to provide patient services (Admissions Agreement); or

D. the entity holds the state awarded Certificate of Need (if applicable).

In some circumstances one or more of these criteria may apply and yet some substantial provisions of the Healthcare Regulatory Agreement—Operator may not apply to the party. In those situations, HUD will evaluate the circumstances and consider the sufficiency and appropriateness of using the Management Certification – Residential Care Facility (Form HUD-9839-ORCF) as an alternative controlling document with that party, including the use of an addendum thereto if appropriate to the particular transaction. Assuring that HUD's interests--including but not limited to its security interest in the license--are fully protected would remain paramount.

Additionally, the licensed Operator, whether or not that Operator is also the Borrower, sometimes itself enters into a further contractual agreement with yet another party with respect to management. ORCF requires that a licensed Operator execute a Healthcare Regulatory Agreement-Operator, regardless of whether the Operator's contract with the project is a Lease, an Operating Agreement, a Management Agreement, or in the case of a Borrower/Operator, as the borrower entity itself. Further, if a party other than the licensed Operator is exercising a managerial role pursuant to a Management Agreement, then that party must execute an ORCF Management Certification-Residential Care Facility.

8.3 Management Agents

A "Management Agent" for purposes of projects insured under Section 232 of the National Housing Act, is an entity that directs the day-to-day functions of a healthcare project as a contracted agent for either the Borrower or the Operator. A Management Agent performs its duties under the oversight of either the Borrower or Operator, as applicable, and is thereupon limited in powers and project authority to the levels expressed by the Borrower and/or Operator in accordance with a negotiated "management agreement." The Management Agent must be approved by ORCF prior to participation, and the management agreement must be approved by HUD prior to execution. A Management Agent is regulated by the management agreement and by the terms of a Management Certification-Residential Care Facility.

The specific duties and restrictions of the Management Agent must be described in the HUD-approved management agreement negotiated between the Borrower and/or the Operator, and such Management Agent. A Management Agent is typically paid a negotiated fee for services provided, often in an amount based on a percentage of gross receipts of the project. All such fees must be sufficiently described in the management agreement. A Management Agent's authority to make expenditures from project accounts must also be defined in the management agreement.

8.4 Operator and Management Agent Qualifications

The Lender must ensure that the proposed Operator and/or Management Agent have the business and healthcare expertise to market and operate the proposed project. Inherent in this expertise is knowledge of the intended clientele, their specific health-related and hospitality needs, and the best approach to meeting these needs. At least one principal or entity of the proposed Operator or Management Agent must have a proven track record of successful operations in the type of project proposed (e.g. Nursing Home, Assisted Living, Memory Care or Board & Care). Principals must have at least 3 years of experience participating in multiple properties. Longer operating histories may be required for participants with only one project. Experience must include developing, marketing, operating, and, as applicable, lease-up of the type of project proposed. Evidence of appropriate experience must be provided that includes specific project examples including project name, type of care provided, location, and unit/bed count. For projects adding units to a market, evidence must also include year opened and key operating metrics (fill pace, occupancy, net operating income margins), and specific responsibilities for the management and operation of the example healthcare project. ORCF is seeking assurance that the Operators and Management Agents are committed to the long-term success of the project and have the requisite experience to operate and manage the project.

8.5 Expectations for Consultant and Contractor Performance

Borrowers, Operators and/or Management Agents may, without ORCF's consent, (but as limited by Program Obligations, the operating lease and the management agreement, as applicable), engage consultants or contractors to provide assistance and/or guidance in specialized areas. Certain engagements of consultant services, such as the hiring of legal counsel, are for services clearly beyond the traditional scope of managerial expertise. Other such engagements may be for consultants that offer a highly specialized skill in a narrow area of project operations, such as pharmacy, psychiatry, rehabilitation management and case coding, and are generally advisory in scope and for a negotiated fee over a limited period of time.

Consultants are distinguished from Management Agents as follows:

A. Consultants make recommendations and have no contractual or other authority to commit or exact resolutions of their own.
B. Consultants advise on matters within specific areas of expertise for a specific time frame.

If an entity, which was presented by the Borrower or Operator to be a consultant, is found by HUD to have project commitment authorities or to be providing a wide scope of managerial services over an extended time period, ORCF may deem the consultant to be a Management Agent and will require that the entity be reviewed and approved as a Management Agent.

8.6 Operating Lease Requirements

For projects in which the Borrower is not the licensed Operator of the healthcare project, the licensed Operator must have a contractual obligation with the Borrower. In the event that this contractual obligation is a lease, the following requirements apply.

The lease payments must be sufficient to (1) enable the Borrower to meet debt service and impound requirements and (2) enable the Operator to properly maintain the project and cover operating expenses. The minimum annual lease payment must be at least 1.05 times the sum of the annual principal, interest, mortgage insurance premium, Reserve for Replacement (R4R) deposit, property insurance and property taxes.

The minimum operating lease term is five years; however, in the event that ORCF is relying on the Operator for experience, a longer term may be required. Amendments for substantive matters may be made during the term of the lease with HUD's prior approval.

The lease must provide a description of the responsibilities of the Borrower and Operator under the terms of the lease including, but not limited to, the following: payment of real estate taxes; maintenance of building; capital improvements; replacement of equipment; property insurance; and fidelity bond coverage.

A. All ORCF leases must incorporate by reference the HUD-required lease addendum

B. **Additional Master Lease Requirements.** Operators that sublease the healthcare project from a master tenant are also subject to those additional operating lease requirements described in detail in Production, Chapter 13.

8.7 Management Agreement Requirements

Either an Operator or Management Agent may have a management agreement. If the contractual obligation between the Borrower and Operator is termed a management agreement, then the management agreement must comply with ORCF's management agreement requirements and Management Agent must execute a management certification.

A. **Required Content:** The parties shall negotiate their own form of agreement provided that it contains language to meet the following HUD requirements:

   1. **Scope of service:** The proposed management agreement shall describe all services the Management Agent will be responsible for performing and for which the Management Agent will be paid management fees. Such description of services shall include an explanation of employee salaries covered by the respective management fees.

2. **Project Authority Limitations:** The management agreement shall define the expenditure limits granted to the Management Agent by the Borrower or Operator.

3. **Required HUD provisions:** All agreements shall provide the following:
    a. Upon failure to comply with the provisions of Management Certification to HUD, or for other good cause, including without limitation for violations of the Borrower's Regulatory Agreement, Operator's Regulatory Agreement, and/or Master Tenant's Regulatory Agreement, if any, thirty (30) days after HUD has mailed to Borrower, or Operator, as applicable, a written notice of its desire to terminate the Management Agreement.
    b. In the event that HUD determines that any of the Permits and Approvals reasonably necessary to operate the Healthcare Facility is at substantial and imminent risk of being terminated, suspended or otherwise restricted, if such termination, suspension or other restriction would have a materially adverse effect on the Project, the Management Agreement shall terminate immediately without penalty upon HUD's issuance of a notice of termination to Borrower, or Operator, as applicable, and such management agent.
    c. The Management Agreement may not be assigned without the prior written approval of HUD.
    d. Upon HUD's request for termination, Borrower, or Operator, as applicable, shall immediately arrange to terminate any such Management Agreement and shall make arrangements satisfactory to HUD for the continuing proper management of the Healthcare Facility and the Project.
    e. If the Management Agreement is terminated the Agent will immediately, not later than thirty (30) calendar days from the effective date of the termination, give to the Borrower (or Operator, if applicable) all of the real and personal property in the Agent's possession or control, including without limitation any of the Project's cash, trust accounts, investments, books and/or records.
    f. The Management Agent cannot be indemnified from liability for gross negligence and/or willful misconduct.
    g. ORCF's rights and requirements will prevail in the event of conflicts between the Management Agreement and program requirements.
    h. Any material amendment to the management agreement must be acceptable to HUD, in accordance with Program Obligations.

4. **Length/term of the agreement.** The length and/or term of the management agreement are to be negotiated amongst the respective parties to such agreement. However, ORCF may require that the term be amended based on the circumstances of a particular approval.
    a. The contract may provide for a fixed term or an open-ended term (e.g., automatically renewable to remain in effect until cancelled by ORCF, and/or the participant parties).
    b. If the length/term of the Agreement changes, ORCF requires the submission of a new Management Certification.

If the project has a Management Agreement with an original fixed term of less than five years, the request needs to include a plan for transitioning to a qualified replacement Management Agent.

5. **Management Fee.** Management agents may be compensated either based on a percentage of project receipts or as a negotiated flat rate on a designated, recurring basis (usually on a monthly basis). However, such fees, incentives, bonuses and other considerations must be clearly designated in the management agreement, must be computed and paid in accordance with HUD Program Obligations, and must be approved by ORCF. The management agreement must describe in sufficient detail all specifics of the Management Agent compensation, including how the management fee will be calculated and whether any incentive or other fees will be paid from surplus cash. ORCF will consider whether such fees are adequate and reasonable for the scope of services proposed. ORCF may require the proposed Management Agent to submit evidence that certain fees are reasonable and customary.

8.8 Lender Responsibilities

The Lender is responsible for reviewing the qualifications of the proposed Operator and/or Management Agent to assess their ability to operate the project effectively and in compliance with ORCF requirements. The Lender must consider each of the below factors in reviewing an Operator and/or Management Agent's qualifications paying particular attention to the Operator and/or Management Agent's past and current experience. In addition, the Lender must review whether a Healthcare Regulatory Agreement-Operator or Management Certification-Residential Care Facility is required for each entity.

A. **Experience:** Experience with projects similar in scope and services to the subject.

B. **Track Record:** A positive track record of compliance with the regulatory requirements of the licensing authority and funders. This includes being in compliance with all laws, regulations and requirements of Federal, State and Local regulatory bodies.

C. **Operational History:** Operational history with regard to billing, controlling operating expenses, vacancy rates, resident turnover, rent collection and accounts receivable/accounts payable, physical security, physical condition and maintenance, resident relations, tenant income certification, and record keeping and reporting if the project is an affordable or subsidized project.

D. **Creditworthiness and Financial Strength:** Creditworthiness and financial strength of the Operator and/or Management Agent. See Production, Chapter 6 for a more detailed explanation of the review requirements.

E. **Previous HUD Experience:** The Lender must review the Previous Participation Certification, to determine whether there are any "Unsatisfactory Management Reviews" or Real Estate Assessment Center (REAC) scores lower than 60. The Lender must provide

ORCF with an explanation of any adverse scores. More information on the Previous Participation Certification is found in Production, Chapter 2, as well as in Housing Notice H 2016-15 (or successors thereto).

F. **Duties and Responsibilities:** Review the description of the duties and responsibilities of the Operator and/or Management Agent (i.e. who will control the operating accounts; contract for services; recruit, select or train employees; take responsibility for the management of the functional operation of the project or the execution of the day to day policies of the project; etc.). Those entities and people responsible for each duty must have sufficient experience carrying out that function.

G. **State Surveys:** Review State surveys for the last three years for all skilled nursing facilities owned/operated and/or managed by the Operator and/or Management Agent and for all skilled nursing facilities on the subject's Professional Liability Insurance policy. Check to see whether the surveys indicate any instances of actual harm and/or immediate jeopardy, or if there are open findings. If this is the case, provide a narrative explanation of the risk <u>and</u> how it will be mitigated.

The Lender must also check to see if any of the facilities owned, operated and/or managed by the Operator and/or Management Agent:

1. are on the Special Focus Facility list or have been notified of being a Special Focus Candidate;

2. have paid Civil Money Penalties above $10,000 and/or had a Ban or Hold on Admissions; or

3. have any pending, current or anticipated rate reductions.

H. **Centers for Medicare & Medicaid (CMS) Star Ratings:** The Lender must review the CMS Star Ratings for the subject and any other facilities that the Operator and/or Management Agent owns, operates or manages. The Lender must discuss the resident care issues for all facilities with one or two stars and remedial steps the participant has taken to date. The Lender must provide an explanation as to why the Operator and/or Management Agent should be allowed to participate in ORCF's programs despite the low scores.

I. **Staffing Levels:** The Lender must provide a listing of the staff whose salaries will be paid from the project's operating account. The list must include:

1. job titles and approximate salary, including hourly rates; and

2. a statement of each position's duties, if not obvious by title and whether the position is full or part-time; and

3. if the employee will be working for more than one project and/or working part-time for the agent in a non-supervisory capacity, a statement of how that person's time and salary will be allocated.

Note: Salaries of Management Agent supervisory staff not assigned to the project must be paid from the management fee. Only full-time, front-line supervisors may be paid from the project account.

The Lender must review job-titles, duties, and salaries of all employees to be working for the project to determine if the number, salaries, and duties of the proposed staff are reasonable for the size and type of the proposed project. The Lender must identify whether the proposed staffing levels are reasonable based on patient acuity, economies of scale of operations, state regulatory requirements, etc.

J. **Project Administrator**: Skilled Nursing Facilities require a licensed Nursing Home Administrator (Administrator). An administrator is an employee of the project or one of the participant entities, who is responsible for directing the day-to-day activities of a project designed for elderly, handicapped, or disabled residents. The administrator typically has a job description and may have an employment agreement, but receives a salary rather than a management fee. The Lender must ensure that the administrator is properly licensed and is qualified to act as administrator for the subject project. The administrator must have at least three years of experience. For existing facilities, the Lender must review the administrator's past performance.

K. **Marketing, Leasing, and (if applicable) Relocation Plan:** All projects which require absorption of beds/units to achieve break-even occupancy must submit a detailed marketing and leasing plan and budget that has been reviewed and confirmed by the proposed Operator and/or Management Agent. The plan must discuss when marketing efforts will begin, when the leasing office and model units will be opened, how the leasing office will be staffed, and the project's marketing and advertising strategy. The plan must address timing of the construction progress schedule with respect to egress and ingress into the project, landscaping, and access to amenities. For projects involving temporary relocation or displacement of existing residents, the plan must address details of timing, funding and management of the relocation process. A relocation budget must clearly identify fixed costs (administrative and other overhead) and variable costs (which vary by the number of residents to be relocated).

L. **Past Performance with Identity-of-Interest Contractors**: If the Borrower, Operator or Management Agent intends to acquire goods or services from identity-of-interest companies and has previously operated FHA-insured projects, the Lender must assess that party's past use of such companies and whether this use resulted in costs to the project that exceed the prices paid in arms–length transactions. The review must especially consider:

1. goods and services purchased through any "pass-through" arrangements;

2. evidence that the agent has compared prices and that the use of any identity-of-interest companies or pass-through arrangements has been more advantageous to the project than purchasing through arms-length transactions would have been; and

3. evidence that the Management Agent followed reasonable contracting and hiring procedures.

M. **Management Fee:** The Lender must review the management fee for adequacy and reasonableness for a project of the scope of services proposed. ORCF may require the Lender to submit evidence that the fee is reasonable and customary.

N. **Fidelity Bond Coverage:** The Lender must assure that the entity that contracts with Medicare and/or Medicaid and the entity that controls the project's operating accounts have Fidelity Bond Coverage of at least two months of underwritten or actual gross potential income, whichever is higher.

O. **Additional Documentation.** The Lender may also utilize the following additional sources, without limitation, to determine the capability and expertise of the proposed Management Agent and Operator:

1. ORCF/Lender on-site review reports;

2. correspondence;

3. resident complaint files;

4. previous management reviews; and

5. reviews from Federal, State or Local government agencies of the Management Agent or Operator's past experience with properties using affordable housing or subsidy programs, if applicable.

If problems are identified with any of the above indicators, the Lender must assess whether the Operator and/or Management Agent have adequately improved their procedures to prevent the recurrence of such problems or whether initiatives by the Operator and/or Management Agent are sufficient to correct the problems and their causes. In addition, the Lender must submit relevant documentation for identified problem areas including letters from Federal/State/Local agencies and plans of action to support their conclusion.

8.9 ORCF Underwriter Review

ORCF will review the Lender's recommendation and application documentation and will make the final determination to accept or reject the proposed Operator and/or Management Agent.

A. **Management Agent Forms:** The ORCF Underwriter will review the Management Certification-Residential Care Facility and the Management Agreement for projects with a Management Agent to assure they meet ORCF requirements and are consistent with the application.

B. **Management Fee:** The ORCF Underwriter will review the Lender's determination regarding the reasonableness of the management fee. ORCF will approve the Management Certification if the management fee is determined to be acceptable.

C. **State Surveys (Skilled Nursing Facilities only):** The ORCF underwriter will review state surveys for the last three years and the Lender's explanation for projects where there are instances of actual harm and/or immediate jeopardy, and for projects with open findings.

D. **Other:** ORCF may also review other pertinent information available. In the instance of existing Section 232 projects, this may include, but not be limited to, past REAC physical inspection scores (if applicable) and referrals to HUD's Departmental Enforcement Center.